United States Court of Appeals

for the Second Circuit

BRIEF FOR APPELLEE

76-6199 & 77-4176

ORIGINAL

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

GENERAL MOTORS CORPORATION, A Corporation of the State of Delaware, PLAINTIFF - APPELLEE

v.

THE LONG ISLAND RAIL ROAD COMPANY, A Corporation of the State of New York, DEFENDANT - APPELLANT

THE LONG ISLAND RAIL ROAD COMPANY,
THIRD PARTY PLAINTIFF - APPELLANT

v.

THE UNITED STATES OF AMERICA and THE INTERSTATE COMMERCE COMMISSION, THIRD PARTY DEFENDANTS - APPELLEES
THE NATIONAL INDUSTRIAL TRAFFIC LEAGUE,
INTERVENING THIRD PARTY DEFENDANT - APPELLEE

ON PETITION FOR REVIEW OF THE ORDER OF THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF NEW YORK

THE LONG ISLAND RAIL ROAD COMPANY, PETITIONER

v

THE UNITED STATES OF AMERICA AND THE INTERSTATE COMMERCE COMMISSION, RESPONDENTS

ON PETITION FOR REVIEW OF THE ORDER OF THE INTERSTATE COMMERCE COMMISSION

JOINT BRIEF FOR THE INTERSTATE COMMERCE COMMISSION AND THE UNITED STATES OF AMERICA

JOHN H. SHENEFIELD
Assistant Attorney General

ROBERT B. NICHOLSON
ROBERT LEWIS THOMPSON
Attorneys
Department of Justice
Washington, DC 20530

MARK L. EVANS
General Counsel

FREDERICK W. READ, III
Associate General Counsel

DAVID POPOWSKI
Attorney
Interstate Commerce Commission
Washington, DC 20423

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JOINT BRIEF FOR THE INTERSTATE COMMERCE COMMISSION AND THE UNITED STATES OF AMERICA

ISSUES PRESENTED

1. Whether the Interstate Commerce Commission and the court below properly interpreted and applied section 1(9) of the Interstate Commerce Act.

2. Whether the Commission rationally determined that the Long Island Rail Road Company failed to meet its burden of showing that its proposed switch connection charge was just and reasonable.

STATUTES INVOLVED

Section 1(9) of the Interstate Commerce Act, 49 U.S.C. 1(9), provides:

> Any common carrier subject to the provisions of this part, upon application of any lateral, branch line of railroad, or of any shipper tendering interstate traffic for transportation, shall construct, maintain, and operate upon reasonable terms a switch connection with any such lateral, branch line of railroad, or private side track which may be constructed to connect with its railroad, where such connection is reasonably practicable and can be put in with safety and will furnish sufficient business to justify the construction and maintenance of the same; and shall furnish cars for the movement of such traffic to the best of its ability without discrimination in favor of or against any such shipper. If any common carrier shall fail to install and operate any such switch or connection as aforesaid, on application therefor in writing by any shipper or owner of such lateral, branch line of railroad, such shipper or owner of such lateral, branch line of railroad may make complaint to the Commission, as provided in section thirteen of this part, and the Commission shall hear and investigate the same and shall determine as to the

> safety and practicability thereof and justification and reasonable compensation therefor, and the Commission may make an order, as provided in section fifteen of this part, directing the common carrier to comply with the provisions of this section in accordance with such order, and such order shall be enforced as hereinafter provided for the enforcement of all other orders by the Commission, other than orders for the payment of money.

Section 15(8) of the Act, 49 U.S.C. 15(8), in pertinent part, provides:

> (a) Whenever a schedule is filed with the Commission by a common carrier by railroad stating a new individual or joint rate, fare or charge, or a new individual or joint classification, regulation, or practice affecting a rate, fare, or charge, the Commission may, upon the complaint of an interested party or upon its own initiative, order a hearing concerning the lawfulness of such rate, fare, charge, classification, regulation or practice. . . .
>
> (f) In any hearing under this section, the burden of proof is on the common carrier by railroad to show that the proposed changed rate, fare, charge, classification, rule, regulation, or practice is just and reasonable.

STATEMENT

1. Nature of the Case

These consolidated cases have been brought by the Long Island Rail Road Company (LIRR) to review and set aside the orders of the Interstate Commerce Commission and United States District Court for the Eastern District of New York in two related cases involving maintenance costs for switching operations which LIRR performs for a shipper, General Motors, at Bethpage, New York. In No. 76-6199, the LIRR seeks review of the Commission

decision in Docket No. 35790, Joint Petition for Declaratory Order -- Private Sidetrack -- General Motors Corporation and the Long Island Rail Road Company, 351 I.C.C. 691 (1976), affirmed in No. 72 C 1549, General Motors Corp. v. The Long Island Rail Road Company, (E.D. N.Y., filed November 19, 1976). In No. 77-4176, the LIRR has petitioned for review of the Commission report and order in Docket No. 36516, Switch Connection Charge at Bethpage, N.Y., Long Island Rail Road, 355 I.C.C. 201 (1977).

2. Facts and Procedural History

The underlying facts in these consolidated judicial proceedings are fairly straightforward, but the procedural history is long and involved.

General Motors Corporation, through one of its unincorporated divisions, General Motors Parts Division, owns and operates a warehousing and distribution facility known as General Motors Parts Distribution Center at Bethpage, New York. The LIRR provides rail service directly to this facility by way of a switch connection which joins the main line of the railroad to a private sidetrack at the distribution center. (Diagram, App. 74a). The General Motors facility receives an average of 10 to 15 railroad carloads of automobile and truck parts per week. (App. 302a).

The switch connection and sidetrack were constructed in 1965. The LIRR paid for the construction of the switch connection as well as a portion of the sidetrack which is located on the railroad's "right-of-way." (App. 303a). General Motors paid for the construction of the remainder of the sidetrack. Since 1965, the LIRR has assumed the expense of maintaining the switch connection and the sidetrack on its right-of-way, while General Motors has maintained the remainder of the sidetrack. (Id.).

The maintenance costs of the switch connection and the railroad portion of the sidetrack are the subject of this controversy. Prior to 1954, the LIRR required all of its shippers who were provided switch connection and sidetrack service to bear the costs of maintaining the switch connection as well as the sidetracks. (App. 227a). In 1954, in order to meet competition from motor transportation and to attract additonal industry to the Long Island area , the LIRR reversed this policy and assumed responsibility for maintaining the switch connections and the portions of sidetracks located on its right-of-ways. (Id.) This policy remained in effect until 1970, when the LIRR, because of soaring deficits in its freight operation

(the LIRR provides primarily passenger service), reinstituted its pre-1954 policy of requiring shippers to pay for the unkeep of switch connections and sidetracks. (Id.)

Following the reinstitution of its prior policy, the LIRR began to renegotiate agreements it had with industries which had private sidetracks.[1/] By 1972, 169 of 278 existing agreements had been modified to provide for shipper payment of maintenance expenses. (App. 227a and 303a).[2/] A sidetrack agreement dated April 1[illegible]972, which provided for shipper maintenance, was tendered to General Motors by the railroad.[3/]

1/ Sidetrack agreements contain a number of provisions relating to the construction and operation of switch connections and sidetracks. Besides a provision dealing with maintenance, there are provisions relating to use, changes or enlargements, and fire and other liabilities. (App. 70a-72a).

2/ The work was to be provided by the railroad with the shipper would to be appropriately billed.

3/ Up to that time, the LIRR and General Motors had not entered into any sidetrack agreement.

(App. 70a). However, General Motors, refused to execute the agreement. The LIRR responded by notifying General Motors that unless it signed the agreement, service to the Bethpage sidetrack would be terminated. (App. 40a).

Faced with this ultimatum, but still unwilling to execute the sidetrack agreement, General Motors initiated Civil Action No. 72-C-1549 in the United States District Court for the Eastern District of New York. General Motors sought a temporary restraining order enjoining the LIRR from discontinuing service to its sidetrack. The court granted General Motors this relief and ordered the LIRR to show cause why a preliminary injunction should not be issued against their ceasing the service they provided General Motors. (App. 5a). The LIRR did not respond to the show cause order, but instead joined with General Motors in a motion to continue the temporary restraining order pending their submission of a joint petition to the Interstate Commerce Commission in which they would request the Commission to issue a declaratory order resolving the dispute between them. (App. 13a). The District court acceded to this request and ordered that the temporary restraining order be continued until the parties received a decision from the Commission. (App. 15a)

The parties filed their petition for a declaratory order, and the Commission instituted the above-mentioned Docket No. 35790, Joint Petition for Declaratory Order - Private Sidetrack - General Motors Corporation and The Long Island Rail Road Company. The Commission directed that this proceeding be handled under its modified procedure.[4/] The National Industrial Traffic League (NITL) intervened in support of General Motors.

In accordance with modified procedure, the LIRR, General Motors, and NITL filed opening statements of fact and argument. General Motors and NITL filed rebuttal or reply statements. Rather than make an immediate determination itself, the Commission first referred this proceeding to an administrative law judge (ALJ) for an initial decision. See 5 U.S.C. 557.

On May 21, 1974, the ALJ issued an initial decision decision in which he concluded that the LIRR could neither 1) require General Motors to bear the subject maintenance expenses, nor 2) discontinue rail service to the Bethpage sidetrack.

4/ This procedure calls for, in effect, a "paper proceeding." It is used at the Commission's discretion "if it appears that substantially all important issues of material fact may be resolved by means of written materials and that the efficient disposition of the proceeding can be made without oral hearing." 49 C.F.R. 1100.43. This rule is included in the Commission's recently revised General Rules of Practice. 42 F.R. 23806, 23813 (1977).

The LIRR filed exceptions to the initial decision (App. 233a), to which General Motors and NITL replied (App. 250a and 278a). In an order served June 17, 1975, the Commission's Division 3 affirmed the findings and conclusions of the ALJ. (App. 285a). In a dissenting opinion Commissioner (now Chairman) O'Neal questioned whether the LIRR should be forever precluded from imposing a maintenance charge on General Motors. (App. 286a).

The LIRR filed a petition for reconsideration. Recognizing that several issues needed clarification, Division 3, acting in an appellate capacity, issued a full report and order on March 17, 1976. (App. 302a), 351 I.C.C. 691. This final decision upheld the Commission's prior determination that the LIRR could not terminate service at Bethpage; however, it agreed with Chairman O'Neal's prior dissent that the LIRR was not absolutely barred from establishing a separate maintenance charge.

The LIRR returned to the district court seeking review of the Commission's report and order. It filed a third-party summons (App. 311a) and complaint (App. 313a) requesting that the Commission and the United States be made parties to the court proceeding. The Commission and the United States answered by admitting that they should

be included. All parties including General Motors and NITL, filed briefs and oral argument was held before the Honorable Jacob Mishler, Chief Judge, United States District Court for the Eastern District of New York. (App. 448a-481a). On November 19, 1976, Chief Judge Mishler issued a "Memorandum of Decision and Order" in which he affirmed the Commission's final findings and conclusions in Docket No. 35790 and granted General Motors a permanent injunction prohibiting the LIRR from suspending service to the Bethpage sidetrack because of General Motors refusal to assume the payment of the subject maintenance expenses. (App. 482a).

The LIRR then took two steps. First, it filed with this Court an appeal of Chief Judge Mishler's decision (No. 76-6199). Second, it filed with the Commission a tariff which sought to impose the disputed maintenance charge on General Motors. (Freight Tariff No. 72). General Motors protested the tariff and the Commission instituted an investigation into its lawfulness, Docket No. 36516, Switch Connection Charge at Bethpage, N.Y. - Long Island Railroad. (App. 571a).[5/] This Court granted LIRR's motion to hold the appeal of the District Court judgment in abeyance pending the disposition of Docket No. 36516 by the Commission.

5/ Although it had the authority to suspend the tariff under Section 15(8)(b), of the Act, 49 U.S.C. 15(8)(b), the Commission declined to do so and the maintenance charge went into effect. The Commission pursuant to section 15(8)(e) of the Act, 49 U.S.C. 15(8)(e), ordered the LIRR to keep account of all amounts it received so that if the Commission found all or any part of the tariff charge to be unlawful, the LIRR could refund the charges collected from General Motors.

The Commission directed that Docket No. 36516 (like Docket No. 35790) be handled under the modified procedure. (App. 572a). As the proponent of the tariff charge, the LIRR had the burden of proof.[6/]

Foregoing an initial decision, the Commission's Division 2, on September 7, 1977, found that the LIRR had not met its burden of showing that its tariff charge was just and reasonable. (App. 785a), 355 I.C.C. 201 (1977). The Commission ordered the LIRR to cancel Freight Tariff No. 72 and refund to General Motors the charges it had collected.

The LIRR filed with this Court a petition for judicial review of Division 2's report and order (No. 77-4176), as well as a petition to the Commission for stay pending judicial review. The Commission denied the stay (App. 807a), and the railroad did not seek a stay from this Court. In an order dated October 17, 1977, this Court consolidated the appeal of the district court judgment (No. 76-6119) with its review of the Division 2's report and order in Docket No. 36516 (No. 77-4176).

6/ See Section 15(8)(f) of the Act, 49 U.S.C. 15(8)(f).

3. The Commission Decision in Docket No. 35790 And Its Affirmance By The District Court

The question of whether the LIRR could cease serving General Motors through the switch connection and private sidetrack at Bethpage, N.Y., has primarily involved the interpretation and applicability of section 1(9) of the Act, 49 U.S.C. 1(9). Section 1(9) provides for the establishment of switch connections by railroads either voluntarily or by Commission order. It directs the railroads to construct and maintain such trackage when it is practicable, safe, and justified by a sufficient amount of business. If the switch connection is established voluntarily, it shall be upon "reasonable terms"; if the connection is instituted at Commission direction, "reasonable compensation" must be determined.

The position of the LIRR before the Commission and the district court (and now before this Court) is that section 1(9) gives a railroad the authority to impose maintenance charges through sidetrack agreements, and that service over a switch connection can be conditioned upon shippers acquiescence in such agreements. (App. 304a), 351 I.C.C. 693. The LIRR argues that in Merchants Refrigerating Co. v. New York Central R. Co., 238 I.C.C. 599 (1940) and Ziegler Bros. v. Southern Ry. Co., 157 I.C.C. 660 (1929),

the Commission interpreted section 1(9) as giving rail carriers an unqualified right free from Commission interference, to require shippers to enter into sidetrack agreements when the carriers have voluntarily installed switch connections. (App. 304-05a), 351 I.C.C. at 693-94. The LIRR advanced a number of other reasons why General Motors should bear the switch connection maintenance costs. Foremost among them was the drastically deteriorating financial condition of the LIRR's overall freight operation. (App. 227-28a).

General Motors replied that the switch connection at Bethpage is an essential part of the LIRR's transportation service which the railroad is obligated to maintain under its line-haul rates.[7/] (App. 306a), 351 I.C.C. at 695.

In its final report and order the Commission concluded that in light of the LIRR's prior absorption of the maintenance expenses, it is inconsistent with the railroad's transportation obligation to require General Motors to pay for maintaining the switch connection other than through line-haul rates. (App. 307a), 351 I.C.C. at 696. The Commission also found that the LIRR had not shown that there

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7/ Line-haul rates are what the railroads charge shippers for the movement of freight from one city or town to another. They contemplate a terminal to terminal service. See, Southern Produce Co. v. Denison & Pac. S. Ry. Co., 165 I.C.C. 423, 435 (1930).

has been any change in the requisite conditions of section 1(9) -- practicability, safety and sufficient business --, and that therefore the railroad is obligated to continue to provide the switch connection service. (Id.) The Commission distinguished Merchants Refrigerating Co., supra, and Ziegler Bros., supra, and concluded that it does indeed have jurisdiction over contract disputes relating to voluntarily installed switch connections. The Commission repudiated its disclaimer of jurisdiction in Zeigler as "unduly broad." (App. 308a), 351 I.C.C. at 697.

As to whether the LIRR was being adequately compensated for the switch connection maintenance by its line-haul rates, the Commission found that the railroad failed to show that its line-haul rates did not fully reimburse it for the maintenance expenses. (App. 308-09a), 351 I.C.C. at 697-98. Because the LIRR already absorbed these costs as a part of its rate base[8/] and recovered them through its line-haul rates -- the Commission concluded that any additional charge could possibly result in the LIRR being unjustly compensated for the maintenance of the switch connections. (App. 308a), 351 I.C.C. at 697. Adopting the view previously expressed by Chairman O'Neal, the Commission

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8/ A railroad's rate base consists of the funds that it has specifically committed to the provision of its services. Net Investment - Railroad Rate Base & Rate of Return, 345 I.C.C. 1492, 1497 (1976). It represents the total investment in the facilities of a public utility employed in providing its service. Priest Principles of Public Utility Regulation, p. 139 (1969).

stressed that the LIRR was not without recourse and could establish separate maintenance charges by meeting the standards described in Atchison, T. & S. F. Ry. Co. v. Wichita Board of Trade. 412 U.S. 800 (1973), (hereinafter Wichita Board of Trade), (App. 309-10a), 351 I.C.C. at 698-99. The Commission stated that the evidence of LIRR's freight deficits was not a substitute for directly showing the reasonableness of imposing the maintenance expenses on General Motors.

The district court affirmed these findings and conclusions of the Commission.[9/] In particular, the district court found that the Commission's interpretation of section 1(9) was reasonable and that its findings as to the section 1(9) conditions and the adequacy of the LIRR's compensation were supported by substantial evidence. (App. 486-88a).

In the district court's view, the basic issue before the Commission was whether the LIRR was receiving reasonable compensation for its maintenance of the switch connection. (App. 488a). Like the Commission, it found that the LIRR had not shown that its line-haul rates were inadequate. Its opinion explained in detail how the LIRR's evidence as to the financial plight of its entire freight

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9/ Referral of questions by a federal district court to the Interstate Commerce Commission is specifically addressed in 28 U.S.C. 1336(b). It provides that the court which referred the question has exclusive jurisdiction to set aside any order arising out of such referral.

operation was inconclusive as to whether line-haul rates adequately compensate the railroad for maintaining the Bethpage switch connection. (App. 488-90a).

Before the district court, the LIRR relied upon an initial decision by an administrative law judge in another Commission proceeding, issued subsequent to the Commission's final report and order in Docket No. 35790, which allowed another railroad to impose switch connection construction and maintenance expenses on a shipper by contract. Docket No. 36413, Allied Container Corp. v. Maine Central Railroad Company (decided April 29, 1976) (App. 224-232a).[10/] The district court distinguished that case from the instant one by noting the differing policies of the two railroads, i.e. that the Maine Central Railroad required the payment of these expenses immediately at the time the switch connection was built, while the LIRR did not. The implication was that maintenance costs were absorbed by LIRR's line-haul rates, but not by the Maine Central's.

Finally, the district court noted that the LIRR was not precluded from recovering its costs and could seek to establish a separate, reasonable maintenance charge, or even try to increase its line-haul rates. (App. 491a).

10/ This decision was adopted in its entirety by the Commission, Division 3, in an order entered October 27, 1976. This order is contained in Addendum A of the LIRR's brief.

4. The Commission Decision In Docket No. 36516

Although it filed an appeal of the district court's decision, the LIRR responded to that court's suggestion and filed a tariff seeking to institute a separate maintenance charge (Freight Tariff No. 72), (App. 520-21a). The amount of the charge was $4.39 per railroad car of automobile parts delivered to the General Motors distribution center at Bethpage. (Id.)

The LIRR was required to show that not only was this charge reasonable, but also that the line-haul rates would be reasonable even though they no longer would include the maintenance service. Wichita Board of Trade, supra, 412 U.S. at 811, 815. The LIRR met the second part of its burden, but not the first. The LIRR showed that the level of its line-haul rates on automobile parts did not cover the variable costs[11/] incurred by the LIRR in providing the line-haul service including the maintenance of switch connections. (App. 797a), 355 I.C.C. at 213. It did not demonstrate, however, that the maintenance charge was reasonable.

11/ "Variable" costs are railroad expenditures which are directly attributable to the specific services railroads perform and vary with "volume of output." See, Rules to Govern Assembling & Presenting Cost Evidence, 337 I.C.C. 298, 305-309 and 428 (1970). Together with a portion of the railroads "fixed" or "constant" costs, they constitute the "fully allocated" costs of various railroad services. Id.

In support of the charge, the LIRR submitted estimates of general and specific (inspection, lubrication and snow removal) maintenance costs to the Commission. The approximations for each were $600 per year. (App. 610a). In addition, it submitted an estimate of the construction costs for the Bethpage switch connection. (App. 610a)). The LIRR based the construction costs on current wage and price levels and approximated that the actual overall cost of the connection in 1965 would be one-half of that figure.[12/] (App. 611a).

Because the LIRR offered no evidence whatsoever to support its estimates of specific or general maintenance expenses, the Commission could not determine "the adequacy or accuracy of either." (App. 214a), 355 I.C.C. at 214. The Commission found that the LIRR's presentation had three other deficiencies. (Id). First, the general and specific maintenance costs were already attributable to other railroad expense accounts (e.g. "Maintenance of Way and Structures"), so recovering those expenses via the proposed charge would require a corresponding reduction in the other accounts.

12/ The purpose of the construction cost figure was to determine annual depreciation which would be an additional expense item, and together with the above maintenance costs would comprise and total amount which the LIRR allegedly expends each year specifically for the switch connection. The total annual figure according to the LIRR is $1,808.00 (App. 611a).

Secondly, the Commission agreed with General Motors that the LIRR had to produce its actual construction costs instead of an estimate since that data should be available to it. And thirdly, even if available, these particular construction costs -- rail and track -- cannot be depreciated and, therefore, should not be considered as part of the LIRR's switch connection expenses. (Id.).

Because of these evidentiary deficiencies the Commission concluded it was "unable to determine what a reasonable level for a maintenance charge would be." (App. 798a), 355 I.C.C. at 214. The Commission ultimately concluded that, "Despite the showing that the existing line-haul rates do not cover variable costs, based on the above [switch connection cost evidence] we find that the [LIRR] failed to meet its burden of proof and that the proposed maintenance charge has not been shown to be just and reasonable." (App. 799a), 355 I.C.C. at 215.

SUMMARY OF ARGUMENT

Because in these consolidated cases this Court is examining a lower court review of a Commission decision and a Commission proceeding involving the lawfulness of a rate or charge, the Court's normally restricted scope or review of agency orders is even more limited. A strong presumption of correctness attaches to a district court affirmance of a Commission order. And in cases where rate matters are considered and the Commission has evaluated evidence of the cost of railroad service, the expertise of the Commission is entitled to particular deference.

These cases are dispositively controlled by Wichita Board of Trade, supra, 412 U.S. 800. In Docket No. 35790 the Commission and the district court properly found that before the LIRR could transfer the expense of maintining the switch connection to General Motors, the railroad had to demonstrate that its line-haul rates, which previously absorbed these costs, no longer compensated the LIRR for providing the maintenance service.

In Docket No. 36516, the Commission rationally concluded that the LIRR had not shown that the separate tariff charge it proposed for the maintenance of the connection was just and reasonable. Its cost presentation was defective in a number of respects and particularly in

its failure to substantiate its estimates of general and specific maintenance expenses.

The less than robust financial condition of the LIRR's freight operation cannot by itself be the basis for permitting the railroad to require General Motors to assume the maintenance costs. In response to the Railroad Revitalization and Regulatory Reform Act of 1976, the Commission has recently begun to routinely consider the general state of a railroad in all railroad rate proceedings. Ex Parte No. 338, Standards and Procedures for the Establishment of Adequate Railroad Revenue Levels (decided February 3, 1978). However, this is only one of a number of factors to be considered and does not supersede the other relevant criteria for determinang the reasonableness of a rate or charge. Although the instant proceedings predated the announcement of the Commission's new policy, the LIRR's freight deficits were nonetheless considered and found to be inconclusive compared with the other elements of the reasonableness test.

ARGUMENT

I.

THE SCOPE OF REVIEW IN BOTH OF THESE CONSOLIDATED CASES IS VERY LIMITED

The general role of the courts in reviewing decisions of administrative agencies is a restricted one. They must sustain agency orders if they are supported by substantial evidence and are not arbitrary and capricious. Section 706 of the Administrative Procedure Act, 5 U.S.C. 706; Bowman Transportation, Inc., 419 U.S. 281, 285-286 (1974); Consolo v. Federal Maritime Commission, 383 U.S. 607, 620-621 (1966). The judicial function is exhausted when there is found to be a rational basis for the conclusions reached by the administrative body. Mississippi Valley Barge Line Co. v. United States, 292 U.S. 282, 286-287 (1934).

The scope of review in these cases is even more limited. First, the district court's affirmance of the Commission's final report and order in Docket No. 35790, creates a strong presumption of its own correctness and of the validity of the Commission's order. Cf., Virginia Railway Company v. United States, 272 U.S. 658, 673 (1926).

Secondly, in reviewing Commission proceedings involving transportation rates and charges, this Court should show particular deference to the Commission's expertise in

these matters. Board of Trade of Kansas City v. United States, 314 U.S. 534, 546 (1946). Rates and ratemaking call "in particular measure for the use of that enlightened judgment which the Commission by training and experience is qualified to perform." Mississippi Valley Barge Co. v. United States, supra, 292 U.S. at 286. The Supreme Court, has acknowledged the special regard that should be given the Commission's assessment of cost evidence in rate cases (such as Docket No. 36516):

> We start, of course, from the premise that on a subject of transportation economics, such as this one, the Commission's judgment is entitled to great weight. The appraisal of cost figures is itself a task for experts, since these costs involve many estimates and assumptions and, unlike a problem in calculus, cannot be proved right or wrong. They are, indeed, only guides to judgment. Their weight and significance require expert appraisal. New York v. United States, 331 U.S. 285, 328 (1947).

Thus, as to Docket No. 36516, there is a strong presumption that the Commission has properly performed its official duties. Interstate Commerce Commission v. Jersey City, 322 U.S. 503, 512 (1943). See also, Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968).

II.

THE LIRR COULD NOT REQUIRE GENERAL MOTORS TO EXECUTE A SIDETRACK AGREEMENT

The LIRR contends that the district court and the Commission have misinterpreted section 1(9) of the Act. It argues that section 1(9) contemplates that 1) a railroad should be compensated for maintaining a switch connection and 2) that it should be allowed to recover those costs through a private sidetrack agreement without regard to their line-haul rates or a separate tariff charge. (Pet. Br. 10-11). The LIRR contends that Merchants Refrigerating Co. v. New York Central R. Co., supra and Allied Container Corp. v. Maine Railraod Company, supra, support its contention. (Pet. Br. 10-11, 13).

While LIRR does have a right under section 1(9) to be compensated for maintaining a switch connection, the railroad had no right whatsoever to require General Motors to enter into the tendered sidetrack agreement as a condition for continued rail service. The two Commission cases relied upon by railroad do not support its contentions. In Merchants Refrigerating Co. and Allied Container Corp., the New York Central Railroad and Maine Central Railroad at the outset of switching operations, required shippers to pay both the construction and maintenance costs pursuant sidetrack agreements.[13/]

13/ In Merchants Refrigerating Co., the New York Central Railroad had built a "spur track" which is generally shorter than a switch connection but performs the same function.

The maintenance costs were never considered as part of the railroads' line-haul rates. In Allied Container Corp., the Maine Central, in constructing a switch connection applied its long-standing policy of requiring the shipper receiving the connection to pay the construction and maintenance expenses under contract. In his initial decision, which was later adopted by the Commission, the ALJ in Allied Container Corp. stated (App. 431a):

> The evidence demonstrates that Maine Central has maintained the same policy for the past 50 years requiring industry to bear the costs of installation and maintenance of private sidetracks including switch connections and spurs or lead tracks. By so doing defendant has not charged those costs to operating expenses they have not formed a part of its rate base, are not recovered by revenue from the line-haul rates and there is no duplication or over compensation.

Regarding the applicability here of Allied Container Corp., supra, the district court in its decision stated (App. 491a):

> By contrast, in the present case, when the Bethpage switch connection was built, the LIRR's policy was not to impose a separate maintenance charge on private sidetrack shippers. By implication, the line haul rates absorbed the maintenance cost of the switch connection. Thus, in 1970, when the LIRR changed its policy of the last sixteen years, and sought to impose an additional maintenance charge, it had the burden of demonstrating that the line haul rates did not already provide adequate compensation for the maintenance of the Bethpage switch connection.

The key question in these cases is what did the railroad require at the time service over the switch connection began. The Commission allowed the Maine Central to recover its maintenance costs through a sidetrack agreement because it had never received compensation from Allied Container or other shippers in any other manner. The Commission refused to permit the LIRR to do the same because the railroad had previously considered switch connection maintenance as an operating expense and factored it into its rate base. Here, the Commission was faced with a classic Wichita Board of Trade situation in which it could not allow the LIRR to collect additional charges without first showing that both its line-haul rates without the inclusion of maintenance services, as well as any separate new charges, were reasonable.

In Wichita Board of Trade, supra, the nation's railroads jointly sought to impose a separate charge for additional services they provided when carloads of grain were stopped in the course of their shipment so that the quality of the grain could be inspected. The railroads had originally provided this "in-transit" inspection service as part of their line-haul rates. The Commission approved this separate charge despite the fact that the railroads had not shown that their line-haul rates would still be at

a just and reasonable level notwithstanding the diminution in service offered. Inspection in Transit, Grain and Grain Products, 339 I.C.C. 364 (1971) and 340 I.C.C. 69 (1971).

On appeal, a three-judge district court,[14] and then the Supreme Court (cite p. 16, supra) determined that the proceeding should be remanded to the Commission because the Commission unlawfully departed from its previously well-established policy of requiring the railroads to show that their line-haul rates would still be just and reasonable. See e.g. Duluth Dockage Absorption, 44 I.C.C. 300 (1917); Unloading Lumber to New York Harbor, 256 I.C.C. 463 (1943); Transit Charges, Southern Territory, 332 I.C.C. 664 (1968). On remand the Commission returned to its standard rule and withdrew its approval of the considered charge. 349 I.C.C. 89 (1975).

The rule of Wichita Board of Trade, dealing with reductions in line-haul services has long been Commission policy.[15] As the Supreme Court stated in the Wichita case:

> [when] the railroads propose to eliminate some of the service previously provided yet charge the same rates, 412 U.S. at 815; [they] must demonstrate both that the proposed charge is reasonable in light of the costs of the separate service, and the total charge for line haul plus the separate service is reasonable. 412 U.S. at 811.

14/ Wichita Board of Trade v. United States, 352 F. Supp. 365 (D. Kansas 1972).

15/ The rule was recently followed in Transit Charges on Soybeans at Points in the South, 351 I.C.C. 366 (1975).

The Court further stated that the explicit purpose of the rule "is to guarantee that shippers receiving the same service that they had previously received do not pay an unreasonable amount." 412 U.S. at 811.

Thus, in the proceeding here under review, the Commission and the District Court required of the LIRR only what is demanded of any railroad which seeks to assess a separate charge for a service which has previously been provided under the railroad's line-haul rate.

III.

THE COMMISSION RATIONALLY DETERMINED THAT THE LIRR DID NOT MEET ITS BURDEN OF SHOWING THAT ITS MAINTENANCE CHARGE WAS JUST AND REASONABLE

A. The LIRR's Burden Of Proof

Section 15(8) of the Act, 49 U.S.C. 15(8), provides, inter alia, that when a tariff schedule stating a new rate, fare or charge is filed with the Commission, the agency, upon complaint of an interested party or on its own initiative, may order a hearing concerning the lawfulness of the rate, fare or charge. 49 U.S.C. 15(8)(a). This provision directs that in any such hearing the burden is on the railroad to show that the proposed rate, fare or charge is just and reasonable. 49 U.S.C. 15(8)(f).

In Docket No. 36516, the LIRR had the burden of showing not only that the switch connection maintenance charge in Freight Tariff No. 72 was just and reasonable, but pursuant to the Wichita Board of Trade rule, it also, has to show that the existing level of its line-haul rates would still be reasonable even though they no longer included the provision of maintenance services. The LIRR failed to show the reasonableness of the proposed maintenance charge.

B. The Deficiencies In The Switch Connection Charge Evidence.

As discussed at pp. 18-19, supra, the Commission did not approve of the proposed $4.39 per car maintenance charge because of various deficiencies in the evidence offered

by the LIRR. (App. 797, 98a), 355 I.C.C. at 213-14. On brief, the LIRR states that the Commission disapproved of the maintenance charge because the LIRR submitted estimates of its maintenance expenses rather than the actual costs. (Pet. Br. 12-13). However, the LIRR has misread Division 2's report. The LIRR submitted estimates of both the maintenance expenses of the switch connection as well as its construction costs. Division 2 found the construction cost estimates unacceptable because actual construction costs were available. (App. 798a), 355 I.C.C. at 214. However, the evidence of maintenance expenses, both specific and general was found to be insufficient not because they were estimates -- but because there was absolutely no evidence in the record to support their accuracy.

The Commission correctly found that construction cost evidence, whether estimated or actual, now has no bearing on this case. Construction costs are used in determining depreciation. Division 2 specifically found that depreciation "is not properly includable as a cost of maintenance of the switch connection." (Id.).

The Commission rationally found that the LIRR's estimates of its maintenance expenses were valueless. The Commission has long recognized that estimates can be useful and it will accord estimates varying degrees of weight

depending on the circumstances of the particular case and the support offered for the figures submitted. See, Air Mail Rates For American Airlines, Inc., 225 I.C.C. 12, 30-31 (1937); Railway Mail Pay, 192 I.C.C. 779, 783 (1933).[16/] Here, however, the LIRR maintenance charge evidence consisted of only a two-page statement by its Assistant Chief Engineer for Maintenance of Way in which he merely stated, without elaboration, that the cost of specific maintenance work (inspection, lubrication and snow removal) was approximately $600 per year and that the cost of general maintenance was the same (App. 610-11a). No explanation was given of how these estimates were calculated. In its brief the LIRR indicates that it will be unable to "pinpoint" its maintenance expenses until General Motors executes a sidetrack agreement and can be billed for work actually done. However, the LIRR has been incurring these expenses for a number of years and a corporation of its size and sophistication certainly has the accounting capability to compute reliable approximations of the cost of this work.

16/ In an early case the Commission expressed the importance of showing the bases for estimated costs. In Joint Rates with Birmingham Southern Railroad Company, 32 I.C.C. 110 (1914), the Commission stated that when a witness is unable to explain the method by which his estimates or results are derived it "greatly diminishes the weight to be attached to his testimony." Id., at 122.

In its brief, the LIRR also suggests that the Commission should have taken upon itself to determine what would be "a permissible reasonable charge." (Pet. Br. 13). But the Commission cannot and will not assume this responsibility unless the cost evidence of record has first been found to be generally acceptable. See, Burlington Northern, Inc. v. United States, 549 F.2d 83, 89 (8th Cir. 1977).

IV.

THE FINANCIAL CONDITION OF THE LIRR'S FREIGHT OPERATION IS INCONCLUSIVE AS TO THE REASONABLENESS OF ITS COMPENSATION FOR MAINTAINING THE SWITCH CONNECTION AT BETHPAGE

It is undisputed that the LIRR's pertinent line-haul rates are below variable costs and that the railroad has experienced some losses in connection with its freight operation. However, the LIRR is wrong when it implies that the financial condition of its freight operations by itself justifies transfering to General Motors the costs of maintaining the switch connection at Bethpage.

In section 205 of Railroad Revitalization and Regulatory Reform Act of 1976, (4R Act), Pub. L. 94-210, 90 Stat. 41, Congress added section 15a(4) to the Interstate Commerce Act and directed the Commission, within two years from the date of the enactment of that provision, to "develop and promulgate (and thereafter revise and maintain) reasonable standards and procedures for the establishment of revenue levels adequate under honest, economical and efficient management to cover total operating expenses." 49 U.S.C. 15a(4). On February 3, 1978, the Commission issued its report in Ex Parte No. 338, Standards and Procedures for the Establishment of Adequate Railroad Revenue Levels. (See Addendum for relevant portions). In this report, the Commission has developed broad guidelines and procedures which are intended to assist

all railroads in attaining sufficient revenues to cover their total operating expenditures. (Addendum, p. 8). In that report the Commission has also addressed the matter of individual rates and has declared that in such proceedings "the revenue adequacy status of each proponent carrier can be taken into consideration." (Addendum, p. 18). However, the Commission has further stated, that: "Revenue adequacy is only one factor to be considered, and does not supersede other pertinent aspects of the reasonableness determination." (Id.).

Although a meritorious innovation in railroad rate-making, the above approach constitutes new Commission policy which, in accord with the timetable mandated by the 4R Act, was not formally adopted until after the conclusion of the proceedings at issue here. In any event, both the Commission and the district court considered the LIRR's financial plight and found it to be "inconclusive" as to whether the LIRR was being adequately compensated for the maintenance of the disputed switch connection. (App. 310a and 489a). Moreover, the relative significance of the railroad's financial condition we submit, was diminished by the "other pertinent aspects of the reasonableness determination." Ex Parte No. 338, Standards and Procedures for The Establishment of Adequate Railroad Revenue Levels. (Addendum, p. 18).

CONCLUSION

The orders of the district court affirming the Commission in Docket No. 35790, and the Commission's report and order in Docket No. 36516 should be affirmed.

Respectfully submitted,

JOHN SHENEFIELD
Assistant Attorney General

BARRY GROSSMAN
ROBERT L. THOMPSON
Department of Justice
Washington, D.C. 20530

MARK L. EVANS
General Counsel

FREDERICK W. READ, III
Associate Genenal Counsel

DAVID POPOWSKI
DAVID POPOWSKI
Attorney
Interstate Commerce Commission
Washington, D.C. 20423

CERTIFICATE OF SERVICE

I hereby certify that on this the 21st day of February 1978, I have served true and accurate copies of the foregoing Joint Brief for the Interstate Commerce Commission and the United States of America upon counsel for all parties of record by first class mail, postage prepaid in the following manner:

GeORGE M. ONKEN, ESQ.
RICHARD H. STOKES, ESQ.
The Long Island Rail Road Company
Jamaica Station
Jamaica, New York 11435

BENSON T. BUCK, ESQ.
LEONARD F. CHARLA, ESQ.
General Motors Corporation
3044 West Grand Blvd.
Detroit, Michigan 48202

JOHN F. DONELAND, ESQ.
FREDERIC WOOD, ESQ.
Donelan & Cleary
914 Washington Building
Washington, DC 20005

ARTHUR M. WISEHART
Bar Building
36 West 44th St.
New York, New York 10036

ROBERT LEWIS THOMPSON, ESQ.
Antitrust Division
Department of Justice
Room 3418
Washington, DC 20530

DAVID POPOWSKI

DAVID POPOWSKI
Attorney

ADDENDUM

INTERSTATE COMMERCE COMMISSION

SERVICE DATE

FEB 3 - 1978

EX PARTE NO. 338

STANDARDS AND PROCEDURES FOR THE ESTABLISHMENT OF ADEQUATE RAILROAD REVENUE LEVELS

Decided January 31, 1978

Upon investigation and consideration of views, arguments, and representations of the parties participating in this proceeding, standards and procedures for the establishment of adequate railroad revenue levels adopted as part 1109.25 of Title 49 of the Code of Federal Regulations.

Curtis H. Berg, Harry L. DeLung, Jr., Christopher C. DeMuth, Richard M. Freeman, Percy W. Johnston, Fritz R. Kahn, Richard W. Kienle, William C. Leiper, Charles N. Marshall, Thormund A. Miller, Charles C. Rettberg, Jr., C. Barry Schaefer, and James L. Tapley for railroads.

Kent Briggs, John I. Finsness, George H. Morin, Frederick C. Stewart, and Robert J. Tosterud for State governments and commissions.

Peter M. Shannon and James R. Taylor for Interstate Commerce Commission's Bureau of Investigations and Enforcement.

Constance L. Abrams, Linda Heller Kamm, and William A. Mentzke for United States Department of Transportation.

Jacob P. Billig, E. F. Bilz, Charles A. Brock, Robert L. Calhoun, Donald C. Cole, Richard B. Cortland, John F. Donelan, Kenneth R. Drottar, John S. Fessenden, Albert J. Francese, Donald A. Frederick, Eugene O. Gehl, John Guandolo, Robert R. Hanson, Sr., Richard J. Hardy, John E. Harvey, Van L. Hayes, Jr., S. J. Huddle, James J. Irlandi, William Jaudes, Donald V. Kane, William Q. Keenan, R. J. Kostach, Arthur D. Lewis, Dickson R. Loos, John K. Maser III, Charles J. McCarthy, Paul C. McQuiston, Charles A. Moran, Roy E. Olson, Judy Rea, Arthur von Rosenberg, Renee D. Rysdahl, David M. Schwartz, William L. Slover, William K. Smith, J. J. Stefanec, Roger J. Stroh, Paul J. Tierney, John P. Tucker, Jr., A. T. Udrys, Robert J. Wager, Kathryn L. Westman, Edwin M. Wheeler, G. A. Wilson, and James D. Zakrajsheck for shippers and other interested parties.

REPORT OF THE COMMISSION

BY THE COMMISSION:

In this report, we are adopting standards and procedures for determining and attaining adequate revenue levels for railroads. The action we take today was mandated by Congress in the Railroad Revitalization and Regulatory Reform Act of 1976 (Pub. L. 94-210). That act created

the present section 15a(4) of the Interstate Commerce Act, which, as pertinent, provides as follows:

> With respect to common carriers by railroad, the Commission shall within 24 months after the date of enactment of this paragraph, after notice and an opportunity for a hearing, develop and promulgate (and thereafter revise and maintain) reasonable standards and procedures for the establishment of revenue levels adequate under honest, economical, and efficient management to cover total operating expenses, including depreciation and obsolescence, plus a fair, reasonable, and economic profit or return (or both) on capital employed in the business. Such revenue levels should (a) provide a flow of net income plus depreciation adequate to support prudent capital outlays, assure the repayment of a reasonable level of debt, permit the raising of needed equity capital, and cover the effects of inflation, and (b) insure retention and attraction of capital in amounts adequate to provide a sound transportation system in the United States. The Commission shall make an adequate and continuing effort to assist such carriers in attaining such revenue levels.

It was for the purpose of promulgating the standards and procedures required by section 15a(4) that this rulemaking proceeding was instituted.

Our notice of proposed rulemaking was published in the Federal Register on March 16, 1977 (42 F.R.14740). In that notice, reprinted as Appendix A to this report, we contemplated that the need for revenue adequacy would be considered in those general rate increase cases where the carriers sought to improve their basic level of earnings. We observed that the need for revenue adequacy would be clearly relevant in such proceedings, and that much of the needed data would be in the record because of existing evidentiary requirements for general rate increase proceedings.

To determine whether revenue adequacy would exist, we proposed to consider three factors: (1) whether there would be a return on net investment equal to the carriers' cost of capital; (2) whether the carriers would have financial ratios indicative of a sound financial condition; and (3) whether the carriers would have a sufficient flow of funds to meet their capital spending requirements. We invited public comment not only on this specific proposal, but also on any other approaches that might be suitable for implementation of section 15a(4).

PROCEDURAL SETTING FOR THE ADEQUATE REVENUE LEVEL DETERMINATION

The notice of rulemaking proposed that the determination of adequate railroad revenue levels be made in those railroad general increase proceedings where an improvement in earnings levels (and not just the recoupment of recent cost increases) is sought. We reasoned that, by virtue of the data requirements promulgated in Ex Parte No. 290, Procedures Governing Rail General Increase Proceedings, 351 I.C.C. 544 (modified and corrected by subsequent orders), such proceedings afford a suitable record for determining revenue adequacy. Moreover, we felt that, where the carriers seek a general rate increase to improve their level of earnings, the analysis of revenue adequacy is clearly relevant.

Most parties indicate neither a preference for, nor an objection to, the proposed use of such general increase cases as the context for making the revenue adequacy determination. The few parties that discuss the proper setting of the revenue adequacy determination, however, are generally in favor of a different procedure. The most detailed comments on the subject were submitted by the railroads. In essence, they favor having the revenue adequacy determination made in independent proceedings conducted at yearly intervals. In such proceedings, the Commission would determine a fair rate of return and the level of revenue that would be adequate under section 15a(4) for the following 12 months. The railroads contend that the making of these findings in independent proceedings would remove a cause of delay in general increase proceedings, and keep the Commission, the shipping public, and Congress aware on a continuing basis of the amount of any shortfall between actual and adequate revenues.

The U.S. Department of Transportation (DOT) also suggests that, each year, the Commission make general findings of revenue need, including rate of return, for the following year. Others favoring separate proceedings for the revenue adequacy determination are the United States Railway Association and General Mills.

Generally, objections by various parties to the railroads' proposal concern a lack of adequate opportunity for consideration of shipper views. These objections do not attack the basic concept of independent proceedings for revenue adequacy determinations.

The American Paper Institute prefers having the revenue adequacy determination made in actual rate proceedings. The Institute fears that independent proceedings would appear deceptively unimportant to shippers, in the absence of an immediate issue as to reasonableness of rates. The approach ultimately favored by the Institute is similar to the one described in the notice of rulemaking, that is, that the revenue adequacy determination be made in the context of those general increase proceedings where improved levels of earnings are sought.

Discussion and Conclusions. Upon consideration of this matter in the light of the parties' comments, we conclude that it would be preferable for the determination of adequate revenue levels to be made in separate periodic proceedings conducted specifically for that purpose. This approach will permit the use of a regular and orderly procedure in which determinations are made on the basis of comparable data each year. This procedure also can be refined as experience is gained, and it will facilitate findings relevant to proceedings other than

general rate increases. At the same time, it will avoid placing an undue emphasis on the use of the general rate increase as the means for attaining adequate revenue.

It is true that the use of independent proceedings may necessitate data requirements that somewhat overlap those now in effect for general rate increase proceedings. However, as discussed in a later section, we have endeavored to keep such overlap to a minimum, and shall seek ways of eliminating it as experience is gained with these proceedings.

Finally, we do not agree with the American Paper Institute that the use of separate proceedings for revenue adequacy determinations would necessarily prevent shippers from recognizing the importance of these determinations. But we will take special steps to assure that shippers are aware of the importance of these proceedings, by giving notice in the Federal Register and by issuing a press release at the inception of each proceeding.

CONSIDERATION OF THE REVENUE ADEQUACY FACTOR IN COMMISSION PROCEEDINGS

Section 15a(4) requires that the Commission devise standards and procedures for the "establishment" of adequate revenue levels. While much of the subsequent language in that section focuses attention on the criteria for determination of

revenue adequacy, it is evident that more than a mere determination is contemplated. The term "establish" is stronger than other terms that could have been used, such as "define" or "determine," and conveys an element of bringing about a condition of revenue adequacy as well as of defining the condition. Moreover, section 15a(4) contains the additional statement that "[t]he Commission shall make an adequate and continuing effort to assist such carriers in attaining such revenue levels."

At the same time, section 101 of the 4-R Act declares it to be the policy of that act, among other things, to "balance the needs of carriers, shippers, and the public." We construe the Congressional view to be that the achievement of adequate revenue levels by the railroads would be in the best interest, not only of the carriers, but also of the shippers and the public. Indeed, many of the shippers who submitted comments in this proceeding expressed their support for the concept of railroad revenue adequacy. We agree with this view. The alternative to revenue adequacy for the railroads is deteriorating service or increasing reliance on public subsidy.

Nevertheless, it is clear that Congress did not intend for our mandate to be simply one of promoting railroad revenues. Consideration of shipper and public interests requires that revenue adequacy be taken not only as a goal but also as a limitation. In other words, to the extent possible, we are to

assist the railroads in attaining revenue adequacy, and to protect the public from having to provide revenues that exceed an adequate level.

The question of when and how the Commission should assist in the attainment of adequate revenue levels was discussed by many of the parties. Consideration of the revenue adequacy factor in both general rate increase proceedings and in individual rate proceedings was discussed.

Consideration of the Revenue Adequacy Factor in General Rate Increase Proceedings

Several parties, including NITL and the National Council of Farmer Cooperatives, would deemphasize the role of the general increase as a means of promoting adequate revenues, and would place greater reliance on improved efficiency and technological advances. They do not indicate, however, that they would dispense with the general increase proceeding altogether. Most parties, in fact, seem to recognize a role of some type for the general rate increase in the railroads' attainment of revenue adequacy.

The notice of rulemaking observed that the revenue adequacy determination is clearly relevant in those general increase proceedings where an improvement in the level of earnings is sought. The Aluminum Association agrees and would limit application of revenue adequacy findings to such proceedings only. Somewhat similarly, the American Paper Institute would give

consideration to revenue adequacy only in relatively infrequent revenue adjustment proceedings that are separate from cost-justified general increases.

The Water Transport Association, however, feels that consideration of revenue adequacy is necessary in cost recoupment cases as well as earnings improvement cases, because of the Commission's statutory obligation to assist the carriers in achieving adequate revenue levels. Similarly, the railroads, DOT and General Mills believe that the revenue adequacy determination, having been made in an independent proceeding, should be considered wherever possible in rate proceedings. The Asphalt Roofing Manufacturing Association believes that proper scrutiny even of cost recoupment proposals requires consideration of overall revenue need.

If revenue adequacy findings are to be considered in judging the reasonableness of a proposed general increase, what weight should be given to such findings? The railroads take the position that, if their revenues are below an adequate level, this fact should have controlling weight in general increase proceedings. In other words, if the revenues anticipated from a proposed increase do not exceed an adequate revenue level, the Commission should permit the increase to become effective. A similar approach is suggested by DOT.

Most of the other parties, however, express strong reservations concerning the degree of rate freedom contemplated by the railroads. The Fertilizer Institute argues that limitations recognized in past cases are still applicable. It feels

that, even though the carriers' revenues may be inadequate, their proposed increases must still be subject to requirements to preserve competitive relationships, avoid self-defeating traffic losses, and minimize adverse environmental effects.

Coca Cola would apply general increases selectively to bring all revenue contributions up to the variable cost level and, like a number of other shippers, would limit profits on the more remunerative traffic. The Upper Great Plains Transportation Institute would distribute increases selectively over all commodities in such a way as to tend to equalize cost/revenue ratios.

Several shippers, including the Southern Hardwood Traffic Association, Agrico Chemical Company and Oxford Chemicals, would require improvements in operating efficiency as a precondition to rate increases. Indeed, the American Bakers Association would require that, for every dollar of a general increase to improve earnings, there be shown a dollar of additional savings from resulting economies and efficiencies.

The railroads would apply revenue adequacy findings to general increase cases on the basis of national composite figures. Similarly, the notice of rulemaking proposed to determine revenue adequacy only on a district and national basis. It observed that detailed findings of revenue need for individual carriers would be difficult to accomplish within the time constraints of a general increase proceeding.

General Mills suggests, however, that such individual carrier findings would be possible in a separate adequate-revenue-level proceeding.

Another reason mentioned in the notice of rulemaking for using only district and national revenue adequacy findings is the argument that carriers within a district are in competition with one another and cannot implement rate increases of differing amounts. The Aluminum Association cautions that financial averages are distorted by the extraordinary weakness of some railroads. It suggests that, if the Commission attempts to bring the national average to an adequate level, some railroads will be permitted to operate inefficiently.

The Southern Companies and others also urge that the differing needs of individual railroads be considered. DOT suggests that averages not be used to disregard the needs of weaker railroads, and that the latter be permitted greater rate increases than carriers whose earnings are more nearly adequate. The railroads, on the other hand, argue that, because of the interrelated nature of the rail transportation system, revenue level adjustments cannot be made on a single-carrier basis. They assert that the dispersion of earnings rates is wide in all competitive industries, and is inevitable in the railroad industry.

Discussion and Conclusions. We believe that the role of the general increase proceeding in the promotion of revenue adequacy should be deemphasized. Rates that are frequently

readjusted by across-the-board percentage increases cease to be optimum rate levels for the individual services to which they apply.

Nevertheless, there are circumstances which cannot always be adequately dealt with by individual rate proceedings. In periods of rapid inflation, prompt across-the-board cost recoupment increases may be necessary to prevent dangerous deterioration in the railroads' financial condition. To bring the rate structure on a particular commodity to a more remunerative level without disrupting competitive relationships, it may be necessary to make an across-the-board adjustment affecting most or all movements of the commodity. Thus, there are circumstances where broad rate increases are necessary.

We no longer see a need to differentiate between cost recoupment proceedings and earnings improvement proceedings. Such a differentiation was made in the notice of rulemaking because we felt that proper attention could not be given to the determination of needed levels of basic earnings in emergency proceedings where recovery of inflationary cost increases is sought. We have now decided to make the determination of adequate revenue levels in a separate proceeding, independent of all general increase proceedings. Accordingly, a finding as to the level of basic revenue need will be available for consideration even in emergency proceedings, and there would be no reason not to take it into account.

We believe that, if the level of railroad revenue is inadequate, every means consistent with a just and reasonable rate structure should be used to help rectify this condition. The general increase, while having many undesirable features, is nevertheless the most direct means of affecting the overall revenue level of the Nation's railroads. We cannot afford to ignore opportunities for movement toward the goal of revenue adequacy that may present themselves in general increases. Therefore, revenue adequacy will be taken into account in such proceedings, and will be regarded as an important factor.

Nevertheless, while revenue adequacy is an important consideration in general increase proceedings, it cannot be the only consideration. General revenue adjustments can have important effects on numerous kinds of competitive relationships, and we must take care, as we have in the past, to avoid undue disruption of such relationships. We must also give effect to other legal requirements that may be applicable. Finally, we must recognize that rate increases which would result in self-defeating traffic losses are, in fact, contrary to the promotion of revenue adequacy and may warrant disapproval for that reason.

We agree with certain shippers that the revenue from every commodity should cover the costs incurred to transport it, and that there can be circumstances in which it is appropriate to limit the contribution obtainable from a profitable

commodity. However, although equality of contribution may be desirable as an ideal, in an emergency or cost based general increase where revenue adequacy is lacking, it would be inappropriate to place undue emphasis on cost/rate ratios. Because of differing demand and competitive circumstances, a greater contribution is available from some commodities than from others. The possible adverse impact of general increases on particular commodities will of course be considered in general rate increases through evaluation of Schedule C data required to be filed by the regulations adopted in Ex Parte No. 290.

Several shippers suggest that the approval of general rate increases be conditioned upon efficiency improvements by the Nation's railroads in general. While denial of a general increase on grounds of inefficient operations could perhaps have the effect of compelling corrective actions, it could certainly also exacerbate operating problems. The problem of inefficiency is one that must be attacked on a broad front, including both adequate revenues for needed services and elimination of unneeded, unprofitable, and duplicative facilities. On a more specific level, inefficiency of an individual carrier's management may lend itself to consideration in certain circumstances, as will be discussed in a later section.

Finally, some of the parties object to having revenue adequacy considered only on a composite basis. As noted in

the notice of rulemaking the nature of transportation competition limits th extent to which the differing needs of individual carriers can be recognized in making general rate adjustments. Nevertheless, in the context of an independent revenue adequacy proceeding, it will be feasible to make revenue adequacy determinations for individual carriers. We shall make such findings, and shall give them such weight in general increase proceedings as may appear appropriate in particular circumstances. As discussed below, these determinations would also be necessary to consider revenue adequacy in individual rate proceedings.

Consideration of the Revenue Adequacy Factor In Individual Rate Proceedings: Reasonableness of Rates

The railroads, and other parties as well, contend that a carrier's revenue adequacy status should be given weight in individual rate proceedings. It is the position of the railroads that the Commission must aggressively and consciously permit higher raes on individual movements whenever allowed by competition. Thus, they contend that a specific increase proposed by an individual railroad should be approved so long as that railroad's overall revenue does not exceed an adequate level.

DOT would accept a carrier's inadequacy of overall revenue as justification for approval of an individual rate yielding more than a proportionate contribution to overhead and capital cost. It would approve individual rate increases as necessary

to move each carrier toward a position of revenue adequacy, and would disapprove rate increases for firms earning more than needed.

The Commission's Bureau of Investigations and Enforcement (BIE) speculates that rate/cost guidelines based on adequate-revenue-level findings could be used to determine how much of a carrier's revenue need should be borne by every commodity. The United States Railway Association, The Transportation Association of America, The Water Transport Association, and General Mills also agree with the general proposition that revenue adequacy findings should be applied in individual rate proceedings.

Most of these parties indicate that separate revenue adequacy determinations for individual carriers would be necessary. The railroads would apply the same fair rate of return to all roads, and would use this percentage to compute adequate revenue levels for individual carriers.

The Fertilizer Institute and the Aluminum Association believe that adequate revenues are only one factor to be considered in individual rate proceedings. The Western Coal Traffic League (WCTL) urges that rate comparisons and rate/cost ratios not be ignored in judging the reasonableness of individual rates. It argues that unfettered demand pricing of captive traffic would cause the eventual loss of such traffic or the cross-subsidization of other commodities. Several other parties express similar views and, like WCTL, would exclude consideration of adequate revenue level findings altogether in individual rate proceedings.

Discussion and Conclusions. Section 15a(4) places no limitation on the regulatory contexts in which revenue adequacy is to be given consideration. Indeed, the emphasis in the 4R Act on giving the carriers greater ratemaking freedom suggests a larger emphasis on the meeting of revenue needs through individual rate adjustments. We conclude that there is a need to encourage individual rate adjustments, as opposed to general rate increases, and that revenue adequacy should be a consideration in individual rate proceedings.

The setting of rates for individual services is complicated by the fact that a railroad incurs fixed or overhead costs from its general operations, in addition to the specific costs caused by the provision of the particular service. Thus, its rates cannot be set simply to cover the costs incurred in providing the particular service, but must be set at a higher level where possible to make a contribution to the coverage of fixed costs. A further complication is that fixed costs cannot be recovered in equal proportions from each service because demand and competitive factors place varying limits on the rates that can be maintained on different types of traffic. Thus, while the Commission is required to limit rates to levels that are just and reasonable, there is no simple formula that can be followed for doing so.

Where the reasonableness of a rate is questioned in an individual proceeding, we consider, among other things, cost

evidence, comparative rate evidence, and circumstances relating to demand and competition. The effect of section 15a(4), we believe, is to require that revenue adequacy also be given explicit consideration in these proceedings. In order to facilitate such consideration, we shall make findings in our periodic independent proceeding as to the adequacy of the overall revenue level of each class I carrier. In individual proceedings, then, the revenue adequacy status of each proponent carrier can be taken into consideration.

A proponent carrier's revenue adequacy status can and should influence the determination as to how high its rate for a particular service may reasonably be set. Where the traffic in question can make a valuable revenue contribution, the fact that the carrier's revenue is less than adequate should certainly be taken into consideration, both in formal proceedings and at the suspension level. Revenue adequacy is only one factor to be considered, and does not supersede other pertinent aspects of the reasonableness determination. Nevertheless, it is an important factor and shall be given the maximum effect possible. Where the rate is one proposed by carriers which have demonstrated revenue need, we will exercise greater restraint in using our suspension powers. For example, despite the 160 percent rate/variable cost figure developed as the general benchmark in Ex Parte No. 320, we would not ordinarily suspend a rate increase proposed by a carrier with revenue need, unless the resulting rate/variable cost relationship were to exceed 180 percent. In this way, our disposition of individual rate proceedings shall assist in the attainment of adequate revenue levels.